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No. 379.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1935.

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

v.

SAN JOAQUIN FRUIT & INVESTMENT COMPANY.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

BRIEF FOR SAN JOAQUIN FRUIT & INVESTMENT COMPANY IN OPPOSITION.

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Opinions Below.

The opinion of the Board of Tax Appeals (R. 253-279) is reported in 28 B. T. A. 395. The opinion of the Circuit Court of Appeals is reported in 77 Fed. (2d) 723.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered May 20, 1935 (R. 344). The petition for certiorari was filed on August 19, 1935. The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Question Presented.

A lease of real estate with option to purchase was obtained by the respondent in 1906 and the option was exercised in 1916. A portion of the property was sold within the taxable years here involved. Was the property "acquired", under the provisions of the Revenue Acts relating to gain or loss, when the option was given, so that the respondent's basis is the value as at March 1, 1913, or was it "acquired" when the option was exercised in 1916, so that the respondent's basis is limited to the amount paid under the terms of the option agreement?

Statutes Involved.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060:

Basis for determining gain or loss.

Sec. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; and

(2) In the case of property acquired on or after that date, the cost thereof; * * *.

* * * * * * * * * *

Revenue Act of 1921, c. 136, 42 Stat. 227, 229:

Basis for determining gain or loss.

Sec. 202. (a) That the basis for ascertaining the gain derived or loss sustained from a sale or other disposition of property, real, personal, or mixed, acquired after February 28, 1913, shall be the cost of such property; * * *.

* * * * * * * * * *

(b) The basis for ascertaining the gain derived or loss sustained from the sale or other disposition of

property, real, personal, or mixed, acquired before March 1, 1913, shall be the same as that provided by subdivision (a); but—

(1) If its fair market price or value as of March 1, 1913, is in excess of such basis, the gain to be included in the gross income shall be the excess of the amount realized therefor over such fair market price or value;

* * * * * * * * *

Revenue Act of 1924, c. 234, 43 Stat. 253, 258:

Basis for determining gain or loss, depletion, and depreciation.

Sec. 204. (a) The basis for determining the gain or loss from the sale or other disposition of property acquired after February 28, 1913, shall be the cost of such property; * * *.

* * * * * * * * *

(b) The basis for determining the gain or loss from the sale or other disposition of property acquired before March 1, 1913, shall be (A) the cost of such property * * * or (B) the fair market value of such property as of March 1, 1913, whichever is greater. * * *

* * * * * * * * *

Statement.

The facts as found by the Board of Tax Appeals (R. 253-279), and as established by the evidence, are summarized as follows:

On October 13, 1906, the Irvine Company leased to the San Joaquin Fruit Company 1,000 acres of bare land in Orange County, California, for ten years, beginning December 1, 1906 (R. 261). By the terms of the lease the lessee was required to plant fruit trees on the land and develop a water supply therefor (R. 261). The lessor was to receive as rent one-fourth of the crops produced on the

leased premises (R. 262). The lessee was given an option to purchase at $200 per acre not in excess of 500 acres of the land before the expiration date of the lease, or to purchase at the expiration of the lease all of the 1,000 acres at the same price per acre; and exercise of the right to purchase portions of the tract during the life of the lease worked a termination of the option to purchase all of the tract on the expiration of the term of the lease (R. 262). The lessee could not assign or transfer the lease or sublet any portion of the land without the written consent of the lessor (R. 262). When the ten-year lease-option was entered into in 1906 the 1,000 acres of land was uncleared desert overgrown with sage brush and cactus (R. 340). The success of the project depended upon obtaining and developing an underground supply of water for irrigation (R. 340, 315, 310). The 1,000 acres required 250 miner's inches of water (R. 311, 315). Within two years, or by the end of 1908—*i. e.*, long before March 1, 1913—the *optionee* sank several wells to depths ranging from 50 to 400 feet and developed an ample and continuous steady supply of water (R. 262, 315, 340). By the end of the year 1909 the optionee had set out 390 acres to orange trees and 600 acres to walnut trees (R. 262), and by the end of the year 1910 the optionee had expended from $150,000 to $170,000 in developing and improving the tract (R. 262, 340). On March 1, 1913, the tract had a value of $1,635,000, and the option to purchase at $200,000 had a value on March 1, 1913, of $1,360,000 (R. 340). At the end of the ten years, that is, on November 30, 1916, the tract had a value of $2,150,000 (R. 340). The optionee was continuously in possession of the tract from the beginning in 1906, and the greatly increased value by March 1, 1913, was a value essentially *created* by the optionee through creative and constructive industry (R. 315-317), to be owned and held permanently as its own, subject only to payment of the purchase price of $200,000. On November 30, 1916, the optionee exercised

the option given in the lease to purchase the 1,000 acres (R. 262, 318).

In 1922, the San Joaquin Fruit Company was reorganized as the San Joaquin Fruit and Investment Company, the respondent, and all of the property was transferred to it (R. 262-264; 273-274).

During the years 1920 to 1928, respondent sold various tracts of the property. In considering respondent's tax liability for these years, the Commissioner determined that the property was acquired on November 30, 1916, when the option was exercised, and that the cost was the $200,000 paid at that time for the land, plus the amounts paid for improvements under the lease agreement, and that this cost figure was the basis for ascertaining gain or loss. The Commissioner's cost figure was not disputed (R. 275).

The Board of Tax Appeals approved the Commissioner's determination. The Circuit Court of Appeals reversed the decision of the Board, holding that the property was acquired in 1906 when the option was given, and that therefore the basis for determining gain or loss was the March 1, 1913, value of the property.

Reasons Against Granting the Writ.

1. The petitioner seeks to show that the decision of the court below is in conflict with *Commissioner* v. *Cummings*, 77 Fed. (2d) 670 (C. C. A. 5), and *Chisholm* v. *Commissioner* (C. C. A. 2), C. C. H. 1935, Vol. 3-A, Par. 9493, Prentice-Hall 1935, Par. 1617; but an examination shows that there is no real conflict. The subject matter in those cases was entirely different and they were simply cases of a bare option to purchase shares of stock, held by an optionee out of possession, who was not in enjoyment of the fruits of the property, and who could not possibly have any property interest whatever in the shares unless and until the option was exercised and the purchase money paid. Moreover, neither of those cases dealt with the question whether an

interest in property had been acquired before March 1, 1913. The facts of those cases differ so widely and completely from this case that there is no possibility of conflict of decisions.

2. The decision below is not inconsistent with *Lucas* v. *North Texas Lumber Company,* 281 U. S. 11, but is supported by it. The subject matter of that case was an executory contract of sales of Texas timberland; the decision turned upon rules relating to title, right of possession, and liability for purchase price, and was based upon the local rule or decision in the cited case of *Gober* v. *Hart,* 36 Tex. 139. The option was a bare option, without more, held by an optionee not in possession. At bar, the option covenant was contained in a lease, and the lease and option were indivisible and interdependent; the consideration went to the whole, and thereby rendered the option irrevocable, *Gordon* v. *Dufresne,* 205 Cal. 512. An option covenant *contained in a lease of land* is a covenant real, *i. e., real property,* and is sharply to be distinguished from an option unconnected with an interest in property such as a lease, *Chapman* v. *Great Western Gypsum Company,* 216 Cal. 420. Furthermore, an optionee in possession of land, who during possession expends some thousands of dollars in improving the land, has an actual interest in the land—an interest real—*Crowell* v. *Ewing,* 4 Cal. App. 358. In the case at bar, the lessee-optionee, in beneficial possession, expended $150,000 to $170,000 in capital improvements of the land before March 1, 1913. The statutory language is "property acquired before March 1, 1913," and the word "property" as used in the Revenue Acts is not used in a restricted sense, nor with any narrow or technical meaning, but has a broad meaning, *Lynch* v. *Alworth-Stephens Company,* 267 U. S. 364, 369; *Commissioner* v. *Stephenson-Adamson Mfg. Company,* 51 Fed. (2d) 681, 682. One may have an interest real, that is, an interest in land, without having a title, an interest in land being a right less than title, *Brown* v. *Sweet,* 95 Cal. App. 117, and it is

unnecessary to the ownership of an interest in real property that the owner be able to give it an historical or conventional name or put it into any particular pigeonhole of the law of real property, *Estate of Pitts,* 218 Cal. 184. The test would appear to be whether the respondent had acquired a "valuable economic interest" on or prior to March 1, 1913, *Palmer* v. *Bender,* 287 U. S. 551, 557. The whole point of the matter at bar is that on March 1, 1913, respondent lessee-optionee had a property interest in the 1,000 acres of land.

3. Petitioner is mistaken in saying that the court below *relied* upon the decision in *Smith* v. *Bangham,* 156 Cal. 359. The court below merely notes that case in the course of discussion in the opinion (R. 343), and adopts an independent view in deciding the date of acquisition of the 1,000 acres, with respect to the statutory language "property acquired before March 1, 1913," as constitutionally interpreted. The principal case of *Richardson* v. *Hardwick,* 106 U. S. 252, cited and quoted by petitioner, is not helpful, being merely a clear illustration of the simplest of all situations, that in which an optionee has never acquired any interest in the land. There a bare option to purchase during a period of two years was given by Hardwick to Richardson, and Richardson permitted the option period of two years to expire without exercising the option. Since the bare option was never exercised, obviously Richardson never at any time had any property interest in the land.

4. The question in the instant case does not have any national importance such as the petitioner attempts to suggest. In the last analysis, the case at bar really turns on the local land law of California, and within that local land law turns on its own special and controlling circumstances (R. 342). The facts are mainly unique, bearing as they do upon a particular arrangement made before March 1, 1913, looking to the easiest possible certainty of financing the transformation of desert and cactus land into orange grove, and it really borders on absurdity for the petitioner to sug-

gest that any decision in the case at bar "will create confusion in numerous tax cases." The probability, if there is any probability at all, that there will ever hereafter be any case resembling the one at bar, is extremely remote. Moreover, no general doctrine of "relation back" is applied or present in the decision of the court below; the option was exercised in 1916, *i. e.*, four years *before* the incidence of the earliest tax (year 1920) involved; and the lease-option was entered into, possession of the land taken, an ample supply of underground water developed, the land set out to orchard, and at least $150,000 expended in capital improvements, *before* the Sixteenth Amendment was even proposed by the Congress to the legislatures of the several states. Compare *Eldredge* v. *U. S.*, 31 Fed. (2d) 924 (C. C. A. 6), and *Commissioner* v. *Pittsburgh Union Stock Yards Company*, 46 Fed. (2d) 646 (C. C. A. 3), in each of which cases an option had been given, possession taken by the optionee, and thousands of dollars expended by the optionee in capital development, and certainty of later exercise of the option established, all of these occurring before March 1, 1913, and being followed by formal exercise of the option subsequent to March 1, 1913. In one of these cases the *res* was a mine and in the other a union stock yard. In both instances it was held that the optionee had acquired a property in the land before March 1, 1913. Neither of these decisions "relating back" the date of acquisition of property to the date of true acquisition before March 1, 1913, has created any national confusion of tax law, and both of them are in accord with the doctrine of "practical ownership" laid down locally in *Laffan* v. *Naglee*, 9 Cal. 663 (*662), wherein a lease-option of a town lot in San Francisco for a term of eight years was made early in the year 1847, followed by the world-famous gold discovery of 1848, and rush of 1849, with a consequent increase in value of the land so great as to make exercise of the purchase-option a certainty.

Conclusion.

There is no real conflict between the decision of the court below and the decisions of other circuits; neither does this case present a question of general interest, since it is based primarily upon California law and the decision of the court below is consistent with the decisions of the State courts.

WHEREFORE, it is respectfully submitted that the petition for certiorari should be denied.

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